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No. 86-776

In the Supreme Court of the United States

OCTOBER TERM, 1986

U S WEST, INC., PETITIONER

v.

UNITED STATES OF AMERICA AND AMERICAN TELEPHONE AND TELEGRAPH COMPANY

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE DISTRICT OF COLUMBIA CIRCUIT

BRIEF FOR THE UNITED STATES IN OPPOSITION

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QUESTION PRESENTED

Whether the consent decree that resulted in the divestiture by the American Telephone and Telegraph Company of its wholly owned local operating subsidiaries is lawfully binding on those subsidiaries.

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OPINIONS BELOW

The opinion of the court of appeals (Pet. App. la-19a) is reported at 797 F.2d 1082. The opinion of the district court (Pet. App. 20a-64a) is reported at 627 F. Supp. 1090. Opinions of the district court at earlier stages of the litigation are reported at 569 F. Supp. 1057 (1983) and 552 F. Supp. 131 (1982).

JURISDICTION

The judgment of the court of appeals was entered on August 15, 1986, and the petition for a writ of certiorari was filed on November 13, 1986. The jurisdiction of this Court is invoked under 28 U.S.C. 1254(1).

STATEMENT

This case involves a challenge to the 1982 antitrust consent decree that required American Telephone & Telegraph Company (AT&T) to divest to its shareholders its 22 wholly

owned Bell operating companies (BOCs), which provide the majority of the nation with local telephone service. Petitioner, U S West, Inc., is one of seven regional holding companies (RHCs) that were created under the consent decree to own and operate the BOCs after the divestiture. Among its many provisions, the consent decree generally prohibits the RHCs and BOCs from engaging in any business other than local telephone services without prior court approval. U S West now claims that the restrictions imposed by the consent decree, and accepted by its former parent corporation (AT&T), violate due process in that AT&T did not adequately represent its subsidiaries during the consent decree proceedings.

A. *Procedural History*

1. On January 14, 1949, the United States filed an antitrust action against AT&T and its subsidiary, Western Electric Company, Inc., alleging that the defendants had monopolized and conspired to restrain trade in the manufacture, distribution, sale and installation of telephones and telephone equipment, in violation of Sections 1, 2, and 3 of the Sherman Act, 15 U.S.C. 1, 2, and 3. In 1956, following periodic negotiations, the government and AT&T settled the lawsuit by entering into a consent decree. That decree generally prohibited AT&T from engaging in any business other than the furnishing of common carrier communications services, except that its Western Electric subsidiary was permitted to manufacture types of equipment used by the Bell System. 552 F. Supp. 131, 135-138 (1982).

2. On November 20, 1974, the United States filed a new antitrust action against AT&T, its Western Electric subsidiary, and a second AT&T subsidiary, Bell Telephone Laboratories. The complaint charged the defendants with monopolization, conspiracy to monopolize, and attempt to monopolize a broad range of telecommunications services

and equipment, in violation of Section 2 of the Sherman Act, 15 U.S.C. 2. The government claimed that AT&T, through its ownership of the 22 BOCs, controlled local telephone exchanges and used that control, in violation of the antitrust laws, first, to discriminate against its competitors and, second, to cross-subsidize its operations in competitive intercity (long distance) and telephone equipment markets.The complaint sought divestiture of the 22 BOCs as well as the divestiture and dissolution of Western Electric. 552 F. Supp. at 139, 160-161.

The case went to trial in 1981. At the close of the government's case in chief the defendants moved to dismiss the complaint, asserting that the government had failed to demonstrate a right to relief. The district court denied the motion.[1] On January 8, 1982, the government and AT&T announced that they had negotiated a proposed consent decree, which they presented to the district court for approval.[2] 552 F.Supp. at 140.

In broad outline, the proposed decree "split the Bell System into two basic parts—the competitive portion of the business, which would provide long distance service, manufacture telecommunications equipment, and conduct research, and the noncompetitive portion of the business, which would continue to have * * * control of local telecommunications service. The competitive portion was to be retained by AT&T and its Western Electric and Bell Labs subsidiaries, while the noncompetitive portion was assigned to the RHCs and their BOC subsidiaries." Pet. App. 3a-4a. The decree provided for divestiture of the 22 BOCs either to the AT&T shareholders directly or to the RHCs, which

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[1]See *United States* v. *AT&T*, 524 F. Supp. 1336 (D.D.C. 1981).

[2]The decree is styled as a Modification of Final Judgment because, technically, it modifies the 1956 final judgment entered in the 1949 case. Pet. App. 72a; 552 F.Supp. at 140-141.

would be owned by the AT&T shareholders. Pet. App. 2a, 73a; 552 F. Supp. at 227.[3] The proposed decree also contained "line of business restrictions" which would generally prohibit the BOCs from engaging in any business except regulated exchange telecommunications and exchange access services.[4] As the government summarized the proposed decree at the time,

> Put in simplest terms, the functional divestiture contemplated by the proposed modification will remove from AT&T the power to employ local exchange services in ways that impede competition in interdependent markets, and will remove from the BOCs, which will retain such power, any incentive to exercise it.[5]

The district court thereafter conducted an extensive proceeding to determine whether the proposed decree was in the public interest. In August 1982, the court approved the proposed consent decree with certain modifications. 552 F. Supp. 131.[6] The court found (*id.* at 165) that "the ability of AT&T to engage in anticompetitive conduct stem[med] largely from its control of the [BOCs]" and it therefore

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[3]The decree also prohibited AT&T from reacquiring the BOCs. 552 F. Supp. at 142 n.44.

[4]The proposed decree contained a general clause prohibiting the BOCs from providing "any other product or service, except exchange telecommunications and exchange access service, that is not a natural monopoly service actually regulated by tariff." In addition, the proposed decree prohibited the RHCs and BOCs from (1) providing interexchange (long distance) service; (2) providing information services; (3) manufacturing telecommunications products or customer premises equipment; (4) marketing such equipment; or (5) providing directory advertising such as the Yellow Pages. 552 F. Supp. at 186, 227-228.

[5]Department of Justice Competitive Impact Statement In Connection with Proposed Modification of Final Judgment, 47 Fed. Reg. 7170, 7178 (1982).

[6]The consent decree, as approved by the court, is appended to the district court's opinion. 552 F. Supp. at 226-234 (Pet. App. 71a-90a).

approved the central feature of the decree: divestiture of the BOCs from AT&T. *Id.* at 160-170. The court also determined (*id.* at 186-195) that it was in the public interest to restrict the BOCs from conducting business after the divestiture in three specific markets: the provision of long distance services (*id.* at 188-189); the provision of information services (*id.* at 189-190); and the manufacture of telephone equipment (*id.* at 190-191).[7]

During the course of the proceedings to review the proposed decree, a number of persons and organizations claimed that the BOCs lacked adequate representation. These parties contended (552 F.Supp. at 220) that "AT&T's interests under the proposed settlement are diametrically opposed to those of the [BOCs], and that AT&T therefore cannot be relied upon to act in the [BOCs'] best interests." Advocates of this view proposed (*ibid.*) either divesting the

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[7]On the other hand, the court ordered removed from the proposed decree certain other restrictions on the future business of the BOCs because the court found that those restrictions did not further the public interest. *Id.* at 191-194. Moreover, the court recognized (*id.* at 194) that, in time, the BOCs might "lose the ability to leverage their monopoly power into the competitive markets from which they must now be barred." It therefore required the parties to incorporate into the decree a mechanism for removal of the line-of-business restrictions "upon a showing that there is no substantial possibility that [a BOC] could use its monopoly power to impede competition in the relevant market" (*id.* at 195). To date, under this provision the court has granted over 100 requests for waivers of the line-of-business restrictions. See, *e.g., United States* v. *Western Electric Co.*, 592 F. Supp. 846, 850-851 (D.D.C. 1984), appeal dismissed, 777 F.2d 23 (D.C. Cir. 1985). The court also noted (552 F. Supp. at 195) that the Department of Justice had undertaken to report to the court every three years concerning the continuing need for the line-of-business restrictions. On February 2, 1987, the Department of Justice filed its first such report, recommending that certain of the restrictions be removed and that others be retained in modified form. See *Report and Recommendations of the United States Concerning the Line of Business Restrictions Imposed on the Bell Operating Companies by the Modification of Final Judgment*, Civ. No. 82-0192, at 1-8.

BOCs immediately and allowing them to participate directly in the restructuring process, or else appointing a guardian *ad litem* to represent their interests. The district court rejected these proposals. *Id.* at 220-222. It noted first (*id.* at 220) that it was "not at all clear that AT&T will act contrary to the interests of the [BOCs]." The court observed (*ibid.*) that AT&T's shareholders were to become the shareholders of the BOCs and therefore AT&T had a fiduciary duty to respect the needs of the BOCs as much as any other part of the corporation. In addition, the court found (*id.* at 221) that "[t]he views which the [BOCs] might be expected to espouse have substantially been presented in this proceeding. With respect to all of the issues which presumably would concern the [BOCs] * * * able parties with able counsel have presented to the Court the factual, legal, and policy arguments bearing upon these questions." The court also found impractical (*id.* at 221-222) the proposals intended to ensure the BOCs adecuate representation. The court agreed (*id.* at 222), however, that the BOCs could "participat[e] * * * [in] the process of implementation of the decree * * * [to ensure that] the plan will leave the companies * * * as viable entities with the resources necessary to perform the functions described in the decree."

This Court summarily affirmed the district court's order approving the proposed consent decree as modified. *Maryland* v. *United States*, 460 U.S. 1001 (1983). Thereafter, AT&T, with Department of Justice concurrence, submitted to the district court a plan for reorganization. After extensive public proceedings, which included testimony from the designated chief executives of several of the RHCs, the court approved the plan with minor changes. 569 F. Supp. 1057 (1983). This Court again summarily affirmed. *California* v. *United States*, 464 U.S. 1013 (1983).

B. *The Present Litigation*

1. The divestiture took effect on January 1, 1984: the RHCs became the owners of the BOCs and the stock of the RHCs was distributed to AT&T's shareholders (Pet. App. 4a). In 1985 a group of RHCs sought a ruling that the decree permitted them to provide exchange telecommunications and access services outside their own exchange areas without prior court approval. Apparently as an afterthought (see Pet. App. 8a n.4), petitioner, alone among the RHCs, suggested in its papers that the decree might not be binding on the RHCs. On January 13, 1986, the district court rejected that argument and otherwise denied the line-of-business requests made by the RHCs. (Pet. App. 20a-64a). The court held that "the [RHCs] are bound by the decree * * * as subsidiaries of AT&T prior to divestiture" (Pet. App. 20a-22a n.2).

2. The court of appeals unanimously affirmed in part and reversed in part (Pet. App. 1a-19a).[8] The court rejected (*id.* at 8a-11a) petitioner's claim that the application of the consent decree to the RHCs and BOCs violated due process. The court observed (*id.* at 8a-9a) that the "due process argument fails because it ignores the facts that AT&T was a party to the antitrust proceeding and both the RHCs and the BOCs were wholly owned subsidiaries of AT&T at the time the consent decree was entered." The court rejected petitioner's "remarkable proposition that a parent may not bind its wholly owned subsidiaries without affording them independent legal representation" (*id.* at 9a). The court also found "specious and irrelevant" the claim that AT&T breached a fiduciary duty owed to the BOCs and RHCs by agreeing to the line-of-business restrictions (*ibid.*). The

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[8]The court reversed certain portions of the district court's line-of-business rulings (Pet. App. 11a-18a). It also declined to reach one aspect of the line-of-business decision, concluding that petitioner lacked standing to raise that issue (*id.* at 18a-19a). The petition does not present any challenge to the court of appeals' line-of-business rulings (Pet. 12-13).

court observed (*ibid.*) that "the only duty owed by AT&T was to its shareholders, who were identical to the initial RHC shareholders."

ARGUMENT

The court of appeals' decision is correct and does not conflict with any decision of this Court or of any other court of appeals. Further review by this Court is not warranted.

The court of appeals concluded that, as a parent corporation, AT&T had the legal authority to bind the RHCs and BOCs in a consent decree. That decision is plainly correct. As a general proposition, this Court has repeatedly made clear that judgments may be binding on persons who are not formally parties to the underlying litigation. See, *e.g., Chicago, R.I. & P. Ry.* v. *Schendel*, 270 U.S. 611 (1926); *Heckman* v. *United States*, 224 U.S. 413 (1912). See also *Southwest Airlines Co.* v. *Texas Int'l Airlines, Inc.*, 546 F.2d 84, 94-95 (5th Cir.), cert. denied, 434 U.S. 832 (1977). For example, judgments may bind those who are privies of a party to the lawsuit. 1B J. Moore, J. Lucas & T. Currier, *Moore's Federal Practice* ¶ 0.411[1], at 386-387 (2d ed. 1983). And among the relationships commonly recognized as " 'sufficiently close' to justify preclusion" (*Southwest Airlines*, 546 F.2d at 95) is the relationship of a parent corporation to its wholly owned subsidiary. See, *e.g., Pan American Match Inc.* v. *Sears, Roebuck & Co.*, 454 F.2d 871, 874 (1st Cir.), cert. denied, 409 U.S. 892 (1972); *Astron Indus. Assoc., Inc.* v. *Chrysler Motors Corp.*, 405 F.2d 958, 961 (5th Cir. 1968). See also *Southmark Properties* v. *Charles House Corp.*, 742 F.2d 862, 870 (5th Cir. 1984); *In re Gottheiner*, 703 F.2d 1136, 1140 (9th Cir. 1983).[9]

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[9]This Court has observed that "[a] parent and its wholly owned subsidiary have a complete unity of interest. Their objectives are common, not disparate; their general corporate actions are guided or

In the present case, AT&T was the sole stockholder of the BOC subsidiaries when the consent decree was entered, and the decree expressly contemplated that after divestiture the same shareholders who owned AT&T would own the divested BOCs (Pet. App. 8a-9a). That "intimate corporate affiliation" (*id.* at 9a) allowed AT&T to act on behalf of, and to bind, its wholly owned subsidiaries.

Petitioner nevertheless contends (Pet. 17-21) that AT&T did not adequately represent its interests during the proceedings to consider the consent decree, in that the parent company "imposed line of business restrictions injurious to the BOCs in a manner which served AT&T's own post-divestiture interests" (*id.* at 17). The district court, affirmed by the court of appeals (Pet. App. 8a-9a), considered this claim in detail and rejected it. 552 F. Supp. at 220-222. The district court noted (*id.* at 220-221) that AT&T owed a fiduciary duty to the post-divestment shareholders of the subsidiaries because prior to the divestiture these owners had been AT&T's shareholders. This duty, the court concluded, together with related factors, ensured adequate representation for the subsidiaries. Moreover, the court observed that the interests of the subsidiaries were fully represented by other participants in the consent decree proceedings (*id.* at 221). The court's findings were not clearly erroneous and warrant no further review by this Court. See *Astron Indus. Assoc., Inc.*, 405 F.2d at 961; *Towle* v. *Boeing Airplane Co.*, 364 F.2d 590, 593 (8th Cir. 1966).

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determined not by two separate corporate consciousnesses, but one. * * * They share a common purpose whether or not the parent keeps a tight rein over the subsidiary; the parent may assert full control at any moment if the subsidiary fails to act in the parent's best interests." *Copperweld Corp.* v. *Independence Tube Corp.*, 467 U.S. 752, 771-772 (1984) (footnote omitted).

Petitioner's reliance (Pet. 24-25) on *Cascade Natural Gas Corp.* v. *El Paso Natural Gas Co.*, 386 U.S. 129 (1967), is misplaced. In *Cascade*, the Court held that certain parties had been denied the right to intervene in divestiture proceedings, and thus that a consent decree negotiated in the absence of those parties could not be enforced. Because the decree had to be remanded for new hearings, the Court went on to note particular ways in which the decree, as negotiated, fell short of what the Court had intended when it ordered the divestiture in an earlier opinion. The Court in *Cascade* did not, as petitioner contends (Pet. 24-25), remand that case because the new company created from the divestiture lacked adequate representation during the divestiture proceedings; it remanded because certain other parties had been denied participation in the proceedings and because, as a result, the decree contained terms that were inconsistent with the Court's previous mandate.[10]

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[10]Petitioner's assertion (Pet. 25-27) that there is an intracircuit conflict between the decision of the court of appeals in this case and its decision in *FTC* v. *Exxon Corp.*, 636 F.2d 1336 (1980), is mistaken. In the *Exxon* case a district court had directed Exxon to "hold separate" a recently acquired competitor while the FTC reviewed the legality of the acquisition. In order to facilitate that basic order, the district court barred lawyers for Exxon from simultaneously representing the competitor that was being held separate. The court of appeals upheld this order, agreeing that the competitor and Exxon had conflicting interests. The court noted, in particular, that "[t]he possible future owner of the [competitor] does not now exist to protect certain interests that are very much involved in the current proceedings" (636 F.2d at 1346). In the present case, by contrast, the future owners of the BOCs and RHCs were specified in the consent decree; moreover, they were simply AT & T's shareholders prior to the divestiture. Unlike Exxon, AT & T had the same fiduciary duty to the future owners of the post-divestiture competitor (here, the BOCs and RHCs) that it had to the rest of the corporation.

CONCLUSION

The petition for a writ of certiorari should be denied.

Respectfully submitted.

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